

Challenges and Opportunities in the Exchange Bond Market

This chapter discusses some of the real and perceived challenges facing specifically the exchange bond market in the PRC, its market institutions, and its participants. This chapter also aims to describe some of the possible mitigating factors or market developments that could address these challenges in an appropriate manner.

A. Challenges in the Exchange Bond Market

The purpose of this section is to state any challenges facing the exchange bond market, together with any remedial action, that is being implemented or in the planning stages.

1. Current Policy Challenges in the Exchange Bond Market

The policy challenges below include an extract from 2017 and 2018 CCDC reports, which to a certain degree are also applicable to the exchange bond market:⁹⁰

- i. Exchange bond market liquidity should be improved by, for example, increasing the participation of the banking sector as the main fixed-income investors in the PRC. Banking sector investors already represent important participants in the CIBM. Following the cooperation between supervisory authorities and policy makers, as well as the securities settlement system agencies and the trading platform operating agencies of both markets, quite a number of banking sector institutions in the CIBM can already invest in instruments listed and traded in the exchange bond market. Consequently, cross-market transactions have been increasing.
- ii. The benchmark role of the government bond yield curve still needs to be improved. It should take into consideration the unified expansion of the primary and secondary government bond markets among the CIBM and exchange bond market.
- iii. It is necessary to strengthen the continuous supervision of bond market intermediaries and control the impact of real risks on the corporate bond market. While credit default events decreased in 2017, compared with the previous year, the corporate bond market continued to show characteristics of companies' heavy debt reliance.
- iv. Lead underwriters, CRAs, and accounting firms should continue to pay close attention in a timely manner to the business and financial situation of issuing companies that they service and conduct regular stress tests to ensure that risks are detected, controlled in time, and properly disposed of.
- v. The need to increase the ability of asset appraisal institutions and bond guarantee institutions to provide services to the bond market and to improve

⁹⁰ CCDC (中央结算公司统计监测部). 2018. *Annual Report on Bond Market Statistical Analysis 2017* (2017 年债券市场统计分析报告年报 2018 年 1 月 16 日). Beijing; CCDC. 2019. *Annual Report on Bond Market Statistical Analysis 2018* (2018 年债券市场统计分析报告 2019 年 1 月 16 日). Beijing.

- their capabilities to exercise their positions fairly was identified as a challenge.
- vi. It is important to provide more sound, appropriate, and convenient financing channels for SMEs, such as SME private placement bonds, and create more appropriate market practices for such instruments.
 - vii. Regarding corporate bonds and enterprise bonds, it is necessary to develop an appropriate risk control mechanism for not only the publicly offered bond market to QIIs but also the non-public placement market. Operating procedures and market practices for the non-public placement market are becoming more important as issuances increase, in order to avoid an unwanted increase in credit risk and event risk.
 - viii. It is important to improve the risk identification and information disclosure mechanism for corporate bonds and ABS, as well as for public bonds and repos.
 - ix. At present, there is no complete and mature evaluation model for risk identification of asset securitization, which requires a more transparent, comprehensive, and favorable information disclosure mechanism. In 2017, ABS issuances accelerated, which necessitated an appropriate information disclosure system to control multiple risks and ensure a fair pricing mechanism. In line with this objective, the SSE and SZSE subsequently issued a series of targeted documents to further clarify and strengthen the application for listing as well as the information disclosure requirements for the asset securitization business.
 - x. It is necessary to further increase the participation channels of overseas institutional investors and improve the openness of the exchange bond market.
 - xi. The introduction of overseas CRAs in the credit rating of issuances in the PRC bond market is conducive to promoting the opening of the bond markets and enhancing the attractiveness of the PRC's bonds. Credit ratings have also been identified as the key to the interconnection of the exchange bond market and the CIBM. In response, the PBOC issued Announcement No. 7 to Liberalize the Credit Rating Business of Overseas Rating Agencies in the Inter-Bank Bond Market in 2017, which gave foreign CRAs the ability to carry out credit rating activities beyond Panda bonds.
 - xii. Due to the different trading venues and regulatory agencies, there are many sets of systems with different value orientations, operating mechanisms, and supervision methods, which may affect the efficiency of bond resource allocation and comprehensive risk prevention and control. It is necessary to adhere to the general direction of market-oriented operation and unified supervision, and clarify various mechanisms such as market access, information disclosure standards, investor suitability, bankruptcy and liquidation, and establish a unified bond supervision system.
 - xiii. The bond market should be linked with other financial product markets to enrich the asset allocation of investors, reduce transaction costs, increase the level of activity in the PRC's financial market, and promote the balanced dispersion of risks across the markets.
 - xiv. At the same time, important key market (including historical) data should be constantly monitored. An overall monitoring function encompassing all bond market segments should be developed in an integrated manner and with transparency.
 - xv. An agreed and coordinated usage of terminology (in Chinese and in English) among all stakeholders in relation to the financial and capital markets is needed to make the market and its terms more compatible with international markets.

B. Opportunities in the Exchange Bond Market

The exchange bond market is the distinct corporate bond market in the PRC. As such, it offers opportunities for many corporate issuers, both domestic and international. The steady increase in the number of issuances and trading volumes on the SSE and SZSE (see also Chapter I.B), as well as the further liberalization of foreign investor activities (see also Chapter II.N), have made the exchange bond market an important segment in the capital market in the PRC.

At the same time, the formalization and proper management of non-public (private) placement and the establishment and proper functioning of the Qualified Investor concept and its exemption mechanism are key to the creation of a recognized professional bond market in the PRC.

1. Establishment of Qualified Investors Concept

The 2015 measures introduced the concept of Qualified Investors, which is a professional investors scheme that, in its features and criteria, corresponds to many similar professional investor schemes in ASEAN+3.

The ability for issuers to issue corporate bonds or enterprise bonds exclusively to Qualified Investors is expected to further drive the demand for such issuances, likely through non-public (private) placements, in the PRC's exchange bond market.

The Qualified Investors concept and its exemption mechanism from full disclosure requirements and the wider usage of English in disclosure documents also put the exchange bond market on track to consider joining other regional professional markets in supporting AMBIF (see also the next section).

2. ASEAN+3 Multi-Currency Bond Issuance Framework

The introduction of AMBIF in regional markets offers an opportunity for issuers in the PRC bond market to use the same issuance documentation and disclosure information across a number of regional markets, if AMBIF were to be supported by policy bodies, regulatory authorities, and SROs in the PRC.

In the exchange bond market, the introduction of the Qualified Investors concept and its exemption mechanism (see above), streamlined CSRC and/or exchange approval for issuances to Qualified Investors, and the consideration of allowing issuance documentation in English, whether as additional material to documentation in Chinese or in place of it, are notable developments toward an AMBIF-eligible marketplace in the PRC.

At the same time, potential issuers have identified the PRC's exchange bond market as one of particular interest, primarily due to the size and attractiveness of such a large market, its focus on corporate (enterprise) bonds, and as a means to support the decentralized funding of domestic business operations in the PRC.

For a more detailed description of AMBIF, please refer to Chapter X.B.